

No. 14,467

IN THE
**United States Court of Appeals
For the Ninth Circuit**

UNITED STATES OF AMERICA,

Appellant,

vs.

JOHN O. ENGLAND, Trustee in Bank-
ruptcy of the Estate of Bradford
Welch, Inc., a Corporation, Bank-
rupt,

Appellee.

On Appeal from the United States District Court
for the Northern District of California.

APPELLEE'S REPLY BRIEF.

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APPELLEE'S REPLY BRIEF.

The facts as set forth in the brief of the United States are not disputed by appellee. Further, the trustee does not deem it necessary to respond to the argument of the Government as to whether it introduced proof sufficient to establish that it had liens for unpaid taxes and interest in the amount of \$945.37 which arose upon the assets of Bradford Welch, Inc. before it was adjudged a bankrupt. The sole question presented is whether or not such liens, good as against the bankrupt, are valid against appellee, the

latter's trustee in bankruptcy, and therefore entitled to payment over and above all other priority claims for taxes filed in the subject bankruptcy proceeding.

UNDER THE PROVISIONS OF SEC. 70 OF THE BANKRUPTCY ACT, THE TRUSTEE IS A JUDGMENT CREDITOR WITH A LIEN, WITH PRIORITY OVER THE GOVERNMENT'S UNRECORDED LIEN.

Priority claims for taxes have been filed in the bankruptcy proceeding by the United States, the Department of Employment of the State of California, the Board of Equalization of the State of California, the Franchise Tax Board of the State of California, and the County of San Mateo and City of San Mateo. The United States claims a lien upon the moneys of the estate, as against these other priority tax claims who have not asserted or filed any liens, and the United States having not recorded such lien or made any seizure of the bankrupt's property prior to the bankruptcy.

It is the contention of the trustee that he took possession of the bankrupt's property as of the date of the bankruptcy with all the rights, remedies, and powers of a creditor then holding a lien thereon, whether or not such a creditor exists, (Section 70(c) of the Bankruptcy Act), and that by reason thereof and the fact that the United States had failed to seize the property prior to the commencement of the bankruptcy proceeding, the proceeds of such property should be distributed ratably among all tax claimants, including the United States.

We concede that if a lien exists, the lienor is entitled to payment before all persons *without liens* who are given priority by Section 64 of the Bankruptcy Act, except that statutory lienors are postponed in certain cases to claimants without lien having priority under Section 64. If there is no surplus above the amount of the liens, there is nothing for creditors who are given priority, nor for general creditors.

Liens for taxes are, of course, statutory; and a statutory lien does not have to be perfected or be a specific lien to come within the protection of Section 67(b) of the Bankruptcy Act. (*United States v. Sampsell*, 153 F. 2d 731 (CCA9).)

Section 3671 of the Internal Revenue Code provides that the lien shall arise at the time the assessment list was received by the Collector of Internal Revenue and shall continue until the liability for such amount is satisfied. Section 3670 of said Code provides, in effect, that until notice of any federal tax lien is filed by the Collector in the office of the Clerk of the United States District Court, the lien shall not be valid as against any mortgagee, purchaser or *judgment creditor*.

It has been declared that a bankruptcy trustee takes the property of a bankrupt charged with tax liens which were specific and complete prior to the filing of the petition in bankruptcy, and also takes the property charged with any other liens then in legal existence. (*Re Taylorcraft Aviation Corp.*, 168 F. 2d 808 (CCA6).)

But a trustee takes not only "the title of the bankrupt but also the rights of a judgment creditor with a lien of the date of adjudication as against conflicting liens." *Re Jackson Light & Traction Co.*, 269 F. 223 (CCA5), and in 4 Remington on Bankruptcy (5th Ed.) 345, the following statement appears:

"Subdivision (c) of Sec. 70, last sentence, therefore vests the trustee with all the rights which any creditor might have secured at bankruptcy had he foreseen the impending bankruptcy and successfully established himself at the moment of bankruptcy with a lien by legal proceedings on all property in the bankrupt's possession and with all the rights of an execution creditor with execution returned nulla bona on other property. By legislative fiat the trustee is instantly vested on his appointment with those rights as of the date of the filing of the bankruptcy petition."

This then raises the question: Does a trustee take possession as a judgment creditor with a lien which, in the absence of any seizure or recordation of a lien by another creditor entitled to lien, places the trustee on a level above such creditor or on a parity with it? And, if so, does not the trustee's lien then revert to the benefit of other priority tax claimants, of the same class as the lien creditor?

"One of the main purposes of the bankruptcy law is to attain a uniform and equitable distribution of bankrupt estates, which would be largely defeated by discrimination between those creditors who had and who had not heard of unrecorded claims."

In re Horton, 31 F. 2d 795 (DCLa).

The above statement had reference to creditors other than tax claimants, but in these days of many conflicting tax agencies the principle can well be applied to that class of creditors.

The Government in its brief has cited a number of cases in support of its argument upon which we desire to dwell.

United States v. Security Trust & Savings Bank, 340 U.S. 47, merely held that the Collector's lien took precedence over an attachment lien which, under California law, is "only a potential right or a contingent lien" until the attaching creditor secures judgment. Justice Jackson's statement therein that "only a judgment creditor in the conventional sense is protected" lends support to appellee. The Court, in making this statement, was merely stating that a creditor with an attachment, not a judgment lien, had to yield to a subsequently *recorded* lien of the Government. We quite agree. But if the trustee is held to be a judgment creditor with a lien, and the Government has not recorded its lien, he should, under the language of the above mentioned decision, take priority over the Government or, at worst, be granted parity with the Government's claim.

In *United States v. City of Greenville*, 118 F. 2d 963, the question was as to the right of a state and county to priority for taxes on real property subsequently assessed over an antecedent lien of the United States, duly recorded. The United States was rightfully given priority.

We also believe that the decision of *United States v. Sands*, 174 F. 2d 304 can be differentiated from the facts in this proceeding. In that matter the referee in bankruptcy had held that no lien was acquired by the Government on the property since no notice thereof had been filed in a local recording office, and hence the claim for taxes was postponed to both the expenses of administration and claims for wages under Section 64(a) of the Bankruptcy Act. However, the property had been seized by the United States two weeks before bankruptcy, and the Appellate Court correctly held that such seizure and possession obviated the necessity of recordation.

Appellant also cites *United States v. Gilbert Associates, Inc.*, 345 U.S. 361. This decision does not, in the opinion of appellee, impair his argument. The facts also differ from those in this proceeding. A very important distinction is that in the *Gilbert* case the United States filed a notice of its lien with the Clerk of the United States District Court (which it did not do in the Bradford Welch proceeding) and the Supreme Court held that it theretofore took precedence over a general lien of the Town of Walpole which under state law was an assessment of a tax in the nature of a judgment. We cannot quarrel with the reasoning of this decision. Section 3672 of the Internal Revenue Code gave strength to the lien of the United States as soon as the lien was filed with the Clerk of the United States District Court and as the Town of Walpole had not either secured a judgment nor recorded a tax lien nor seized the property, the Government was entitled to priority.

Also in the case of *United States v. City of New Britain*, 347 U.S. 81, a conflict existed between the United States and state taxing agencies through the attempt of the latter to assert precedence of state law over that of Congress. The Court pointed out that the taxpayer was not insolvent and that the property involved was real and not personal and went on to say that:

“This case is distinguishable from *United States v. Gilbert Associates, Inc.*, because that was a case involving personal property and insolvency of the taxpayer.”

The trustee is not asserting any right under state statute. He is basing his contentions on the language of Section 70(c) of the Bankruptcy Act.

While the Court for this Circuit has not had occasion to pass upon the question upon which this appeal is based, it did say in *Sampsell v. Straub*, 194 F. 2d 228, a case concerned with the effect of the recordation of a homestead by the bankrupt after his adjudication:

“Referring to Secs. 3 sub. a(3) and 67, sub. a,— both sections are designed to prevent creditors of the bankrupt who obtained no preferred status in the normal course of the business transactions out of which their claim arose, from later impressing the property of the insolvent debtor with liens obtained thru diligent resort to legal proceedings. Their purpose is thus to implement a fundamental policy of maintenance of equality among general creditors after insolvency . . .

“Sec. 70, sub. c, on the other hand, is employed primarily to protect general creditors of the bank-

rupt against secret liens. To this end the trustee is given all the rights which a creditor with a lien by legal or equitable proceedings would enjoy. The trustee unquestionably enjoys the right of a creditor who has levied attachment or execution on the bankrupt's property.

* * * * *

"For whether its impact on a particular case is upon secret liens or upon some other impediment to the distribution of the debtor, Sec. 70 sub. c, embodies a comprehensive conception of according the trustee such status as a diligent general creditor might have achieved but for the intervention of bankruptcy."

The above language may well be applied to the subject controversy. The United States did not levy upon or seize the property of the bankrupt before it came into the possession of the trustee. The trustee "enjoys the right of a creditor who has levied attachment or execution on the bankrupt's property." Then he may be considered to hold the property of the bankrupt under a lien based upon actual physical seizure and possession, which would take priority over the "paper" lien of the United States.

We may even go so far as to denominate this latter lien a secret lien, as other tax claimants or authorities would have no knowledge of it when the Collector approved its assessment. It is so general and all inclusive, (extending, as it does, to all property, whether real or personal, belonging to a person liable to pay any United States tax, and including, as it does, interest, penalty, additional amount, or addition

to such tax, together with costs), as to defeat the interest and purpose of the Bankruptcy Act in providing its own tests of priority, security, and payment to creditors. The generality and all pervasiveness strikes at the very foundation of the Bankruptcy Administration so far as personal property owned by a bankrupt is concerned. No notice to the bankrupt's (taxpayer's) debtors is given and none is required, since neither the extent nor location of the delinquent taxpayer's property may be known to the collector. It is completely possible that all of the assets of a bankrupt might be impressed with the lien of Section 3670 of the Internal Revenue Code to the exclusion of all other supposedly secured creditors in the bankruptcy proceeding. Each such creditor might have furnished the materials or labor used in the business completely in ignorance of the tax lien having been filed and no matter how he may attempt to secure himself for payment find that under Section 3670 he is subsequent in right to the United States.

In the instant case, even granting that the lien of the United States under the section extends to debts owed to its delinquent taxpayer, the bankrupt herein, no attempt to reduce the debts to its possession was made, no effort to apply the lien to any specific property was attempted, no proceeding of any variety was initiated to make definite or certain the property to be covered by the lien. Thus, it is submitted that the Government's general lien should, in bankruptcy, be considered inchoate and ineffective as against the trustee herein.

CONCLUSION.

It is submitted that the order of the District Court affirming the order of the referee in bankruptcy disallowing the claim of the Government that it had valid liens for unpaid taxes and interest in the amount of \$945.37 which were entitled to the priority of payment, should be affirmed.

Dated, San Francisco, California,
January 26, 1955.

Respectfully submitted,
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Attorney for Appellee.